

# CLERK'S COPY

## TRANSCRIPT OF RECORD

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Supreme Court of the United States

OCTOBER TERM, 1945

No. 36

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THE JOHN KELLEY COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR CERTIORARI FILED FEBRUARY 14, 1945.

CERTIORARI GRANTED APRIL 30, 1945.

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, A. D. 1944.

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No.

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THE JOHN KELLEY COMPANY,

*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF  
APPEALS FOR THE SEVENTH CIRCUIT.

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TRANSCRIPT OF RECORD

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In the  
**United States Circuit Court of Appeals**  
**For the Seventh Circuit**

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No. 8426

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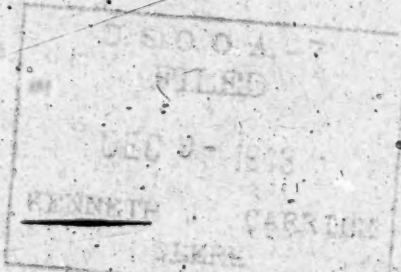
COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

*vs.*

THE JOHN KELLEY COMPANY,

*Respondent.*



Petition for Review of Decision of the Tax Court of the  
United States.

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THE GUTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

TRANSCRIPT OF RECORD FILED OCT. 4, 1943.  
PRINTED RECORD.





In the  
**United States Circuit Court of Appeals**  
**For the Seventh Circuit**

No. 8426

COMMISSIONER OF INTERNAL REVENUE,  
*Petitioner,*

*vs.*

THE JOHN KELLEY COMPANY,  
*Respondent.*

Petition for Review of Decision of the Tax Court of the  
United States.



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1	The John Kelley Company,	}	Docket No. 109088.
	<i>Petitioner,</i>		
	<i>vs.</i>		
	Commissioner of Internal Revenue,		
	<i>Respondent.</i>		

Appearances:

For Taxpayer: E. H. Davis, Esq., Frank J. Albus, Esq.

For Comm'r: John D. Kiley, Esq.

DOCKET ENTRIES.

1941

Nov. 5—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 5—Copy of petition served on General Counsel.

Dec. 9—Answer filed by General Counsel.

Dec. 9—Request for hearing in Indianapolis, Indiana filed by General Counsel.

Dec. 11—Notice issued placing proceeding on Indianapolis, Ind. calendar. Answer and request served.

1942

Apr. 8—Hearing set May 18, 1942 in Indianapolis, Indiana.

May 18—Hearing had before Mr. Turner on the merits. Submitted. Respondent granted leave to file amended answer. Amended answer filed. (Copies served.) Appearance of Frank J. Albus, Esq. filed. Stipulation of facts filed. Briefs due July 15, 1942. Replies Aug. 15, 1942.

June 20—Transcript of hearing 5-18-42 filed.

June 23—Supplemental stipulation of facts filed.

July 9—Brief filed by General Counsel. Served 7-15-42.

July 15—Brief filed by taxpayer. 7-15-42 Copy served.

Aug. 22—Motion for leave to file the attached reply brief, brief lodged filed by taxpayer. 8-22-42 Granted.

Aug. 24—Copy of motion and reply brief served on General Counsel.

Dec. 5—Stipulation re correction in "Exhibit F" filed.

1943

Jan. 15—Findings of fact and opinion rendered, Turner, Judge, Div. 8. Decision will be entered under Rule 50. 1-18-43 Copy served.



Feb. 2—Computation of deficiency filed by General Counsel.

Feb. 9—Hearing set March 3, 1943 on settlement.

Feb. 17—Consent to settlement filed by taxpayer.

Feb. 19—Decision entered, Turner, Judge, Div. 8.

May 18—Petition for review by U. S. Circuit Court of Appeals, 7th Circuit, filed by General Counsel.

May 18—Statement of points filed by General Counsel.

May 18—Notice of filing petition for review and statement of points (sent to Frank J. Albus) filed.

2 May 21—Proof of service of filing petition for review and statement of points filed. (Frank J. Albus.)

May 25—Proof of service of filing petition for review and statement of points filed by General Counsel.

June 23—Motion for extension to 8-16-43 to transmit record filed by General Counsel.

June 23—Order enlarging time to Aug. 16, 1943 to prepare and deliver the record entered.

Aug. 11—Certified copy of order from the U. S. Circuit Court of Appeals, 7th Circuit, extending the time to Oct. 16, 1943 to file the record filed.

Sept. 17—Designation of contents of record filed by General Counsel with proof of service thereon.

## 3

## UNITED STATES BOARD OF TAX APPEALS.

The John Kelley Company,  
Petitioner,

vs.

Commissioner of Internal Revenue,  
Respondent.

} Docket Number 109088.

## PETITION.

(Filed Nov. 5, 1941.)

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, symbols IT:C:EK, dated August 11, 1941, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at Second and Washington Streets, Marion, Indiana. The returns for the periods here involved were filed with the Collector of Internal Revenue at Indianapolis, Indiana.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on August 11, 1941.

3. The taxes in controversy are income and excess profits taxes for the calendar years 1937, 1938, and 1939 in the following amounts:

Year	Income Tax	Excess Profits Tax
1937.....	\$ 569.06	\$360.00
1938.....	1,980.00	None
1939.....	1,980.00	None
Totals.....	<u>\$4,529.06</u>	<u>\$360.00</u>

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) In computing the taxable net income of the petitioner for the calendar year 1937, the Commissioner refused to allow as a deduction from gross income interest paid or accrued during the year in the amount of \$6,000.00.

(b) In computing the taxable net income of the petitioner for the calendar year 1938, the Commissioner refused to allow as a deduction from gross income interest paid or accrued during the year in the amount of \$12,000.00.

(c) In computing the taxable net income of the petitioner for the calendar year 1939, the Commissioner refused to allow as a deduction from gross income interest paid or accrued during the year in the amount of \$12,000.00.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) On January 11, 1937, the Board of Directors of the corporation authorized the issuance of debenture bonds to be designated "20 Year 8% Income Debentures" of a total par value of \$250,000.00. The action of the Board of Directors was approved by the stockholders of the corporation at a meeting held on the same date.

(b) Prior to July 1, 1937, the corporation issued \$150,000.00 par value of the "20 Year 8% Income Debentures", of which \$114,648.00 par value was issued in exchange for 1,124 shares of the corporation's outstanding preferred stock, and \$35,352.00 par value was issued for cash.

(c) During the period July 1, 1937 to December 31, 1937, the corporation had outstanding debentures of a par value of \$150,000.00 on which interest accrued at the rate of 8% per annum. The amount of interest which accrued on these debentures during the last six months of 1937 was \$6,000.00, and this amount was set up on the books of the corporation as accrued interest payable; the amount was paid and was claimed as a deduction in computing the taxable net income of the corporation for the calendar year 1937.

(d) During the calendar year 1938, the corporation had outstanding debentures of a par value of \$150,000.00, on which interest accrued at the rate of 8% per annum. The amount of interest which accrued on these debentures during the calendar year 1938 was \$12,000.00, and this amount was set up on the books of the corporation as accrued interest payable; the amount was paid and was claimed as a deduction in computing the taxable net income of the corporation for the calendar year 1938.

5 (e) During the calendar year 1939, the corporation had outstanding debentures of a par value of \$150,000.00, on which interest accrued at the rate of 8% per annum. The amount of interest which accrued on these debentures during the calendar year 1939 was \$12,000.00, and this amount was set up on the books of the corporation as accrued interest payable; the amount was paid and was claimed as a deduction in computing the taxable net income of the corporation for the calendar year 1939.

(f) During the years 1937, 1938, and 1939 the petitioner made sales on the installment plan, and, in respect to such sales, kept its books and reported income on the installment basis. In all other respects, the petitioner's books were kept and its income reported on the accrual basis.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that—

(a) The amount of \$6,000.00 for the calendar year 1937 was an interest payment on bonds outstanding and was deductible in computing the taxable net income for the calendar year 1937, and there is no deficiency for the calendar year 1937.

(b) The amount of \$12,000.00 for the calendar year 1938 was an interest payment on bonds outstanding and was deductible in computing the taxable net income for the calendar year 1938, and there is no deficiency for the calendar year 1938.

(c) The amount of \$12,000.00 for the calendar year 1939 was an interest payment on bonds outstanding and was deductible in computing the taxable net income for the calendar year 1939, and there is no deficiency for the calendar year 1939.

E. H. Davis,  
Counsel for Petitioner,  
7 So. Dearborn Street,  
Chicago, Illinois.

6 State of Illinois }  
County of Cook } ss.

Roy F. Kelley, being duly sworn, says that he is the Secretary-Treasurer of The John Kelley Company, petitioner named above, and is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

Roy F. Kelley,  
Roy F. Kelley.

Subscribed and sworn to before me, a Notary Public, this the 4th day of November, 1941.

Ruth Stephens,  
Notary Public.

(Seal)

My commission expires January 8, 1944.

EXHIBIT "A".

TREASURY DEPARTMENT  
Internal Revenue Service  
Indianapolis, Indiana  
August 11, 1941

The John Kelley Company  
Second and Washington Streets  
Marion, Indiana  
Gentlemen:

You are advised that the determination of your income tax liability for the taxable years 1937, 1938 and 1939 disclosed a deficiency of \$4,529.06 and that the determination

of your excess-profits tax liability for the years mentioned discloses a deficiency of \$360.00, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Indianapolis, Ind. for the attention of ..... The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,  
*Commissioner,*

By (Signed) Robert E. Wilson,  
*Acting Internal Revenue Agent  
in Charge.*

Enclosures:  
Statement.  
Form of waiver.  
EX/ter



*Petition.*

7

8

**Statement.**

**The John Kelley Company**  
**Second and Washington Streets**  
**Marion, Indiana**

**Tax Liability for the Taxable Years ended**  
**December 31, 1937, December 31, 1938 and December 31,**

**1939**

**Income Tax**

Year	Liability	Assessed	Deficiency
1937	\$18,826.08	\$18,257.02	\$ 569.06
1938	11,052.06	9,072.06	1,980.00
1939	13,624.37	11,644.37	1,980.00
<b>Total</b>	<b>\$43,502.51</b>	<b>\$38,973.45</b>	<b>\$4,529.06</b>
<b>Excess-Profits Tax</b>			
1937	\$ 691.29	\$ 331.29	\$ 360.00
<b>Total</b>	<b>\$ 691.29</b>	<b>\$ 331.29</b>	<b>\$ 360.00</b>

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the report of examination dated October 7, 1940, to your protest dated November 22, 1940 and to the statements made at the conferences held on February 4, 1941 and August 7, 1941.

A copy of this letter and statement has been mailed to your representative, Mr. J. M. Tackett, 7 Dearborn Street, Chicago, Illinois, in accordance with the authority contained in the power of attorney executed by you and on file with this office.

9 **The John Kelley Company**  
**Marion, Indiana**

**Adjustments to Net Income**

**1937**

Net income as disclosed by return	\$110,665.33
Unallowable deductions and additional income	
(a) Reorganization expense	\$ 606.50
(b) Interest on debentures	6,000.00
	<u>6,606.50</u>
<b>Net income adjusted</b>	<b>\$117,271.83</b>

## Explanation of Adjustments

(a) The item of reorganization expense in the amount of \$606.50 is held to be a capital expenditure not deductible from income in accordance with Section 24 of the Revenue Act of 1936 and Article 24-2, Regulations 94.

(b) The item of interest paid on debentures in the amount of \$6,000.00 is held to represent dividends not deductible from income in accordance with Section 23 of the Revenue Act of 1936.

## Computation of Tax

## Corporation

1937

Value of capital stock as declared in the capital stock tax return for the year ended 6/30/37	\$1,011,822.98
Net income for excess-profits tax computation	\$ 117,271.83
Less: Dividends received credit	4,568.07
Balance of net income	\$ 112,703.76
Less: 10% of capital stock declared value	101,182.30
Net income subject to excess-profits tax	\$ 11,521.46
Amount taxable at 6 percent	\$ 11,521.46
Excess-profits tax at 6 percent	\$ 691.29
Total excess-profits tax	\$ 691.29
10 Amount forwarded	\$ 691.29
Excess-profits tax previously assessed:	
Account No. 403501	\$290.87
Account No. 5-52022	40.42
	331.29
Deficiency of excess-profits tax	\$ 360.00
Income Tax Computation:	
Net income	\$ 117,271.83
Less: Excess-profits tax	\$ 691.29
Dividend received credit	4,568.07
Interest on obligations of U. S.	1,737.50
	6,996.86
Normal net income	\$ 110,274.97

Tax on portion of income not in excess of \$2,000.00	\$ 2,000.00	8%	\$ 160.00
Tax on portion of income in excess of \$2,000.00 and not in excess of \$15,000.00	13,000.00	11%	1,430.00
Tax on portion of income in excess of \$15,000.00 and not in excess of \$40,000.00	25,000.00	13%	3,250.00
Tax on portion of income in excess of \$40,000.00	70,274.97	15%	10,541.25
Total normal tax			\$ 15,381.25
Surtax on Undistributed Profits:			
Net income			\$ 117,271.83
Less: Normal tax	\$15,381.25		
Excess-profits tax	691.29		
Interest on obligations of United States	1,737.50		17,810.04
Adjusted net income			\$ 99,461.79
Less: Dividends paid credit			70,422.00
Undistributed net income			\$ 29,039.79
11-Balance forwarded			\$ 29,039.79
Less: Specific credit allowable			—0—
Remainder subject to surtax			\$ 29,039.79
Tax on \$9,946.18 at 7%	\$ 696.23		
Tax on \$9,946.18 at 12%	1,193.54		
Tax on \$9,147.43 at 17%	1,555.06		
Amount of tax			\$ 3,444.83
Total Normal Tax and Surtax			\$ 18,826.08
Normal tax previously assessed:			
Account No. 403501	\$18,097.52		
Additional normal tax as- sessed:			
Account No. 5-52022	159.50		
			18,257.02
Deficiency in normal tax			\$ 569.06

## Adjustments to Net Income

-1938

Net income as disclosed by return	\$ 55,441.01
Unallowable deductions and additional income	
(a) Interest	\$12,000.00
	<u>12,000.00</u>
Net income adjusted	\$ 67,441.01

## Explanation of Adjustments

(a) The item of interest paid on debentures in the amount of \$12,000.00 is held to represent dividends not deductible from income in accordance with Section 23 of the Revenue Act of 1938.

## 12 Computation of Tax Corporation

Value of capital stock as declared in the capital stock tax return for year ended 6/30/38	\$1,250,000.00
Net income for excess-profits tax computation	\$ 67,441.01
Less: Dividends received credit	<u>2,490.25</u>
Balance of net income	\$ 64,950.76
Less: 10 percent of capital stock declared value	<u>125,000.00</u>
Net income subject to excess-profits tax	None
Excess-profits tax previously assessed:	
Account No. 400254	None
Deficiency in excess-profits tax	None
Tax on Corporations in General	
Net income for excess-profits tax computation	\$ 67,441.01
Less: Excess-profits tax	<u>None</u>
Net income	\$ 67,441.01
Less: Interest on obligations of the United States, etc.	<u>3,341.50</u>

Adjusted net income	\$ 64,099.51
Tentative tax at 19 percent	\$ 12,178.91
Less: 14.025 percent of credit for dividends received	\$410.89
2½ percent of the dividends paid credit (not to exceed 2½ percent of adjusted net income)	715.96

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1,126.85

Total Income Tax	\$ 11,052.06
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Less: Tax previously assessed: Account No. 400254	9,072.06
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Deficiency in income tax	\$ 1,980.00
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13                      Adjustments to Net Income  
   1939

Net income as disclosed by return	\$ 73,096.39
Allowable deductions and additional in- come:	

(a) Interest on debentures	12,000.00
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Net income adjusted	\$ 85,096.39
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Explanation of Adjustments

This item of interest paid on debentures in the amount of \$12,000.00 is held to represent dividends not deductible from income in accordance with Section 23 of the Revenue Act of 1938.



# Computation of Tax Corporation

## Excess-profits tax computation:

Value of capital stock as declared in the  
capital stock tax return for year ended  
6/30/39 \$1,285,461.01

Net income for excess-profits tax computa-  
tion \$ 85,096.39

Less: Dividends received credit 2,534.53

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Balance of net income \$ 82,561.86

Less: 10 percent of capital stock declared  
value 128,546.10

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Net income subject to excess-profits tax None

Excess-profits tax previously assessed: None

Account No. 400210 None

Deficiency in excess-profits tax None

## 14 Tax on Corporations in General:

Net income for excess-profits tax compu-  
tation \$ 85,096.39

Less: Excess-profits tax None

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Net income \$ 85,096.39

Less: Interest on obligations of the United  
States, etc. 1,226.48

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Adjusted net income \$ 83,869.91

Tentative tax at 19 percent \$ 15,935.28

Less: 14.025 percent of credit  
for dividends received \$ 418.20

2½ percent of the dividends  
paid credit (not to exceed

2½ percent of adjusted  
net income

1,892.71

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2,310.91

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Total tax under General Rule \$ 13,624.37

Total Income Tax \$ 13,624.37

Less:

Tax Previously Assessed:

Account No. 400210 11,644.37

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Deficiency in tax \$ 1,980.00

15 UNITED STATES BOARD OF TAX APPEALS.  
(Caption—109088)

AMENDED ANSWER.

(Filed May 18, 1942.)

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for amended answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income and excess-profits taxes for the year 1937 and income taxes for the calendar years 1938 and 1939, but denies that the amounts in controversy are as alleged in paragraph 3 of the petition.

4. (a), (b) and (c) Denies that the Commissioner erred as alleged in subparagraphs (a), (b) and (c) of paragraph 4 of the petition.

16 5. (a) and (b) Denies the allegations of fact contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition, except that it is admitted that \$6,000.00 was set up on the books of the corporation as accrued interest payable, and claimed as a deduction in computing taxable net income of the corporation for the calendar year 1937.

(d) Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition, except that it is admitted that \$12,000.00 was set up on the books of the corporation as accrued interest payable, and claimed as a deduction in computing taxable net income of the corporation for the calendar year 1938.

(e) Denies the allegations contained in subparagraph (e) of paragraph 5 of the petition, except that it is admitted that \$12,000.00 was set up on the books of the corporation as accrued interest payable, and claimed as a deduction in computing taxable net income of the corporation for the calendar year 1939.

(f) Denies the allegations contained in subparagraph

(f) of paragraph 5 of the petition, except that it is admitted that the petitioner's books are kept and its income reported on the accrual basis.

17 6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

7. Further answering the petition the respondent avers (a) that in his final notice of deficiency the Commissioner, in computing the surtax on undistributed profits, has increased the dividend paid credit claimed in the returns for the years 1937, 1938 and 1939 in the amounts of \$6,000.00, \$12,000.00 and \$12,000.00, respectively; (b) that these adjustments were brought about by reason of the Commissioner's action in determining that said amounts claimed as interest was in effect distributions of dividends; and (c) that in the event the Board should hold that said amounts or some part thereof constituted interest, the dividend paid credit as to each of the years 1937, 1938 and 1939 should be reduced by a corresponding amount.

Wherefore, respondent prays that the Board redetermine the deficiencies herein to be the amounts determined by the Commissioner, viz: \$569.06 in income tax and \$360.00 in excess-profits tax for the year 1937; \$1,980.00 in income tax for the year 1938; and \$1,980.00 in income tax for the year 1939.

(Signed) J. P. Wenchel,  
F. R. S.  
J. P. Wenchel,  
Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

F. R. Shearer,  
Division Counsel.  
John D. Kiley,  
Special Attorney,  
Bureau of Internal Revenue.

18 EXCERPT FROM TRANSCRIPT OF HEARING  
AT INDIANAPOLIS, INDIANA, ON MAY 18, 1942,  
CONSISTING OF LINES 9, PAGE 33, TO AND  
INCLUDING LINE 24, PAGE 34.

By Mr. Albus:

Q. Mr. Kelly, we have read into the record certain book entries regarding the manner in which these bonds were

entered on your books at various times, some indicating making reference to stocks and others making reference to income debentures. Do you have any explanation for those differences?

A. We had a great deal of trouble with our book system in 1937. We had three different bookkeepers during that year. One of them, evidently, put it down stock and the rest just seemed to copy it and call it anything they wanted.

Mr. Kiley: That calls for a conclusion of the witness. I move it be stricken as not being responsive. The reason, that is a supposition, the reason that motivated these people to do that is purely speculative. He don't know why they did it.

The Member: How many bookkeepers did you say you had?

The Witness: Three.

The Member: Did you ever give them instructions about it?

The Witness: I never gave them any instructions about it, no sir. I never told them anything about it.

The Member: The motion will be granted.

By Mr. Albus:

Q. Mr. Kelly, when was the first time you knew there were any discrepancies in your books in this regard?

A. In the fall of 1940, when Mr. Hiller, the Internal Revenue man called my attention to it.

Mr. Albus: That is all Your Honor.

The Member: Any question, Mr. Kiley?

Mr. Kiley: Just a couple.

*Cross-Examination by Mr. Kiley.*

Q. In 1937 and 1938 and 1939, if I understood your testimony correctly, you were secretary and treasurer of the company?

A. Yes.

Q. And you had charge of the books and records—they were your responsibility were they?

A. Yes.

## .STIPULATION.

(Filed Dec. 5, 1942.)

Exhibit F attached to the Stipulation in the above case is a typewritten copy of the trust indenture under which the debentures involved in the case were issued. In said Exhibit F there is set forth the text of the debentures to be issued under the trust instrument. In the preparation of this document there occurred a typographical error with the result that a part of the first paragraph of the text of the indenture was omitted. It is hereby stipulated and agreed that the first paragraph of the text of the trust indenture appearing in Exhibit F should read as follows:

“The John Kelley Company, an Indiana corporation, for value received promises to pay to the  
21 bearer on the 31st day of December, 1956, the sum of \_\_\_\_\_ Dollars (\$\_\_\_\_\_) in lawful money of the United States of America at the office of the company in Marion, Indiana and to pay interest thereon in like lawful money, out of the net income of the Company, at the rate of 8% per annum, payable annually on the 31st day of December of each year, at the office of the Company in Marion, Indiana, on presentation of this debenture for endorsement of payment thereon, conditioned however, upon the net income of the Company being sufficient during any interest period to pay the amount due as interest, in accord with the terms and provisions hereof. The interest on this income debenture shall not be cumulative.”

The aforesaid correction causes the text of the debentures as set forth in the trust indenture to conform to the printed form of the debenture which constitutes Exhibit E of the stipulation.

Frank J. Albus,  
Attorney for Petitioner.  
(Signed) J. P. Wentzel,  
OWS  
Attorney for Respondent.



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## EXHIBIT "E"

## UNITED STATES OF AMERICA

## Form of Debenture

No. 89

\$1,000.00

The John Kelley Company

20 Year 8% Income Debenture

The John Kelley Company, an Indiana corporation, for value received, promises to pay to the bearer on the 31st day of December, 1956, the sum of

One Thousand Dollars (\$1,000)

in lawful money of the United States of America at the office of the Company in Marion, Indiana, and to pay interest thereon in like lawful money, out of the net income of the Company, at the rate of 8% per annum, payable annually on the 31st day of December of each year, at the office of the Company in Marion, Indiana, on presentation of this Debenture for endorsement of payment thereon, conditioned, however, upon the net income of the Company being sufficient during any interest period to pay the amount due as interest, in accord with the terms and provisions hereof. The interest on this Income Debenture shall not be cumulative.

This debenture bond is one of an authorized issued of debentures of the Company in the aggregate principal amount of Two Hundred, Fifty Thousand Dollars (\$250,000.00) all of like tenor and effect, known as its "20 Year 8% Income Debentures" of various denominations; all of which are issued, received and held subject to all the terms and conditions, and entitled to all the benefits specified in a trust agreement dated January 1, 1937, made by and between The John Kelley Company and Mabel K. Ronald and Roy F. Kelley, as Trustees, to which trust agreement reference is hereby made for a description of the rights of the holders of such debentures, and of the Trustees with respect to the enforcement thereof.

This debenture may be redeemed at the option of the Company on any interest date prior to maturity upon notice in the manner and upon the terms provided in the trust agreement by payment of its principal amount and accrued interest to the date of redemption; after such re-

demption date, interest on the debentures called for redemption shall cease unless payment thereof shall be refused after presentation. All debentures purchased or redeemed by the Trustees shall be cancelled and not re-issued.

If any of the events of default specified in the trust agreement shall occur, all debentures outstanding hereunder may be declared to be due and payable in the manner and with the effect provided in the trust agreement.

In the payment of their claims, all creditors, other than the stockholders of the Company, shall rank superior to the holders of this income debenture, but all holders of this income debenture shall rank *pari passu* with each other and superior to the stockholders of the corporation with respect to their share stock.

This debenture shall not be valid or become obligatory for any purpose unless and until the certificate endorsed hereon shall have been executed by the Trustees under said trust agreement.

In Witness Whereof, The John Kelley Company has caused this debenture to be signed by its President or Vice-President, and its corporate seal to be hereunto affixed and attested by its Secretary or an Assistant Secretary as of the first day of January, 1937.

The John Kelley Company

By .....  
President

Attest:

.....  
Secretary

(U. S. Revenue Stamps required by law have been affixed and duly cancelled.)

23

### Trustee's Certificate

This is one of the 20 Year Income Debentures described in the within mentioned Trust Agreement.

.....  
Mabel K. Rorald

.....  
Roy F. Kelley  
Trustees

## UNITED STATES OF AMERICA

No. 89

The John Kelley

Company

20 Year 8% Income

Debenture

\$1000.00

Principal Payable

December 31, 1956

Interest Payable Annually On

December 31st

Principal Payable at

The Office of the Company

Marion, Indiana

## 24. EXHIBIT "F".

## Trust Indenture.

This Trust Indenture made as of the 1st day of January, 1937 by and between The John Kelley Company, a corporation duly organized and existing under and by virtue of the laws of the State of Indiana, (hereinafter occasionally referred to as the "Company") party of the first part, and Mabel K. Ronald and Roy F. Kelley, as Trustees, (hereinafter occasionally referred to as the "Trustees"),

## Witnesseth:

Whereas, the Company pursuant to a plan of reorganization and recapitalization has determined to issue Twenty Year 8% Income Debentures, in substantially the form and terms hereinafter specified, of the aggregate principal amount of Two Hundred, Fifty Thousand Dollars, (\$250,000.00), said Debentures to be issued in various denominations; and

Whereas, all acts and proceedings necessary and required by law to make said debentures, when executed by the Company and authenticated by the Trustees, as in this Indenture provided, valid, binding and legal negotiable obligations of the Company, and to constitute this indenture a valid and effective agreement, have been done and taken, and the execution, issue and delivery of this indenture have in all respects been duly authorized by the Directors and Shareholders of the Company in full conformity to law; and

Whereas, the text of all the debentures to be issued hereunder and the Trustees' certificate to be endorsed upon the debentures are to be in substantially the following forms, respectively, viz.:

### UNITED STATES OF AMERICA.

No. \_\_\_\_\_

The John Kelley Company

20 Year 8% Income Debentures.

The John Kelley Company, an Indiana corporation, for value received promises to pay to the bearer on the 31st day of December, 1956, the sum of \_\_\_\_\_

Dollars (\$ \_\_\_\_\_) in lawful money, out of the net income of the Company, at the rate of 8% per annum, payable annually on the 31st day of December of each year, at the office of the Company in Marion, Indiana, on presentation of this debenture for endorsement of payment thereon, conditioned, however, upon the net income of the Company being sufficient during any interest period to pay the amount due as interest, in accord with the terms and provisions hereof. The interest on this income debenture shall not be cumulative.

This debenture bond is one of an authorized issue of debentures of the Company in the aggregate principal amount of Two Hundred, Fifty Thousand Dollars (\$250,000.00) all of like tenor and effect, known as its "20 year 8% Income Debentures" of various denominations; all of which are issued, received and held subject to all the terms and conditions, and entitled to all the benefits specified in a trust agreement dated January 1, 1937, made by and between The John Kelley Company and Mabel K. Ronald and Roy F. Kelley, as Trustees, to which trust agreement reference is hereby made for a description of the rights of the holders.

of such debentures, and of the Trustees with respect to the enforcement thereof.

25 This debenture may be redeemed at the option of the Company on any interest date prior to maturity upon notice in the manner and upon the terms provided in the trust agreement by payment of its principal amount and accrued interest to the date of redemption; after such redemption date, interest on the debentures called for redemption shall cease unless payment thereof shall be refused after presentation. All debentures purchased or redeemed by the Trustees shall be cancelled and not reissued.

If any of the events of default specified in the trust agreement shall occur, all debentures outstanding hereunder may be declared to be due and payable in the manner and with the effect provided in the trust agreement.

In the payment of their claims, all creditors, other than the stockholders of the Company, shall rank superior to the holders of this income debenture, but all holders of this income debenture shall rank *pari passu* with each other and superior to the stockholders of the corporation with respect to their share stock.

This debenture shall not be valid or become obligatory for any purpose unless and until the certificate endorsed hereon shall have been executed by the Trustees under said trust agreement.

In Witness Whereof, The John Kelley Company has caused this debenture to be signed by its president or vice-president and its corporate seal to be hereunto affixed and attested by its secretary or an assistant secretary as of the first day of January, 1937.

The John Kelley Company,

By \_\_\_\_\_

*President.*

Attest:

\_\_\_\_\_  
*Secretary.*

(U. S. Revenue Stamps required by law have been affixed and duly cancelled.)



## Trustees' Certificate.

This is one of the 20 Year Income Debentures described in the within mentioned trust agreement.

Mabel K. Ronald,

Roy F. Kelley,  
*Trustees.*

and, Whereas, the execution and issue of said debentures in said amount of Two Hundred, Fifty Thousand Dollars (\$250,000.00) and the execution and delivery of this Trust Agreement have been in all respects duly authorized:

Now, Therefore, This Trust Agreement Witnesseth:

That to declare the terms and conditions upon which said debentures are to be authenticated and delivered by the Trustees and in consideration of the premises and of the purchase and acceptance of said debentures by the holders thereof and of the covenants herein contained, the 26 Company covenants and agrees with the Trustees, for the equal benefit of all present and future holders of said debentures, or any of them, as follows:

## Article I.

## Execution and Issue of Debentures.

Section 1. The debentures shall be executed and issued in the name and on behalf of the Company, signed by its President or a Vice-president with the corporate seal of the Company affixed thereto, attested by its secretary or an assistant secretary. They shall be payable to bearer. The debentures and Trustees certificates shall be substantially of the tenor and purport hereinbefore set forth.

Immediately upon the execution and delivery of this Trust Agreement the Company shall execute and deliver to the Trustees Two Hundred Fifty Thousand Dollars (\$250,000.00) in aggregate principal amount of the said debentures. These debentures shall thereupon be authenticated by the Trustee, who shall sign the certificate provided therefor, and no debenture shall be valid or become obligatory for any purpose or be entitled to any right or benefit under this Trust Agreement until it shall have been authenticated. The debenture when so authenticated shall be delivered in

accordance with the orders of the Company, evidenced by a writing or writings, signed by its president or vice-president and its secretary or an assistant secretary. The total aggregate principal amount of debentures which may be executed by the Company and authenticated by the Trustees is limited to Two Hundred, Fifty Thousand Dollars (\$250,000.00) except that further debentures may be executed, authenticated and delivered to replace debentures which have been mutilated, destroyed or lost, as herein provided.

## Article II.

### Covenants of the Company.

Section 1. The Company covenants that it will promptly pay or cause to be paid to every holder of any debenture issued hereunder the principal and interest accruing thereon in lawful money of the United States of America, on the dates and at the place and in the manner mentioned in said debentures. The interest on the debentures shall be payable only upon presentation thereof for endorsement thereon.

The Company covenants to pay to the Trustees sufficient funds to pay principal and interest five (5) business days before maturity thereof.

Section 2. The Company covenants that there are no liens or encumbrances on its real or personal property, and that so long as any of the debentures issued hereunder are outstanding the Company will not mortgage, pledge, or otherwise encumber any of its real or personal property owned at the date hereof or hereafter acquired.

Section 3. The Company covenants that so long as any of the debentures issued hereunder are outstanding, it will at all times keep all its buildings, plants, equipment, merchandise and fixtures and other insurable property properly insured against loss or damage by fire to the extent that such property is usually insured by companies operating retail stores and properties of a similar character.

27 Section 4. The Company covenants that so long as any of the debentures issued hereunder are outstanding it will pay to the holders thereof the full amount of interest stipulated to be paid therein before it shall declare a dividend to the holders of the common stock of the Company.

## Article III.

## Redemption of Debentures.

Section 1. The Company shall have the right to call, pay and redeem, on any interest day, all or any of said debentures at the principal amounts thereof and accrued interest. If less than all of the said debentures are called, then the debentures so called shall be drawn by lot in such manner as may be determined by the Company.

Section 2. Notice of the time and place of payment shall be mailed or delivered to the known holders and if less than all of said debentures are so called, the numbers and denominations of the debentures so called shall be stated in such notice.

Debentures called for redemption shall be payable at the office of the Trustees. The Company shall deposit with the Trustees not less than five days before the redemption date, cash sufficient to pay and redeem all debentures so called.

On the redemption date fixed in said notice the rights of the holders of said debentures, except to receive the redemption price, and accrued interest to said date, shall cease and said debentures shall be surrendered before payment.

## Article IV.

## Default and Remedies.

Section 1. If one or more of the following events of default happen, viz.: (a) if default be made in the punctual payment of any installment of interest on any outstanding debenture or debentures or (b) if default be made in the observance or performance of any of the terms of said debentures or of this Trust Agreement, and any such last named default shall continue for a period of two (2) years after written notice thereof shall have been given to the Company by the Trustees (whose duty it shall be to give such notice at the request in writing of at least twenty-five per cent (25%) in principal amount of the debentures at the time outstanding hereunder), then and in every such case, the Trustees may, and upon the written request of the holders of twenty-five per cent (25%) in principal amount of the debentures then outstanding hereunder shall declare the principal of all debentures then outstanding here-

under to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, anything in this Trust Agreement or in said debentures contained to the contrary notwithstanding.

This provision, however, is subject to the conditions that if at any time after the principal of said debentures shall have been so declared due and payable, and before any judgment or decree for the payment of monies due shall have been entered, all arrears of interest upon all the debentures shall have been duly paid and all defaults shall have been made good, and all the stipulations of said debentures and of this Trust Agreement shall have been fully performed by the Company, then, and in every such case, the holders of a majority in principal amount of the de-

28      hentures then outstanding, by written notice to the Company and to the Trustees, may waive such default and its consequence and rescind such declaration; but no such waiver or rescission shall extend to or affect any subsequent default or impair any right consequent thereon.

Section 2. The company covenants that (a) in case default shall be made in the punctual payment of any installment of interest on any outstanding debenture or debentures and such default shall have continued for a period of two (2) years; or (b) in case default shall be made in the payment of the principal of any such debenture or debentures when the same shall become payable, whether upon maturity or upon call, or declaration as provided in this Trust Agreement, then upon demand of the Trustees the Company will pay to the Trustees for the benefit of the holders of the debentures issued hereunder and then outstanding, the whole amount which then shall have become due and payable on all such debentures then outstanding and in addition thereto such further amount as shall be sufficient to cover the costs and expenses of collection, including a reasonable compensation to the Trustees, their agents, attorneys and counsel, and any expenses or liability incurred by the Trustees hereunder. In case the Company shall fail forthwith to pay such amount on such demand, the Trustees in their own names and as Trustees of an express trust shall be entitled and empowered to institute such action or proceeding at law or in equity, as may be advised by counsel, for the collection of the sums so due and unpaid and may prosecute any such action or proceeding to judgment or final decree and may enforce any such judgment or decree in the manner provided by law.

Section 3. All rights of action under this Trust Agreement or under any of said debentures may be enforced by the Trustees without the possession of any of the debentures or the production thereof on any trial or other proceedings instituted by the Trustees may be brought in their names as Trustees and any recovery of judgment shall be for the ratable benefit of the holders of said debentures.

Upon the written request of the holders of 25% in principal amount of the debentures at the time outstanding and upon being indemnified to its satisfaction for any liability which they may incur, it shall be the duty of the Trustees to take all necessary or proper steps for the protection and enforcement of their rights and the rights of the holders of the debentures, whether by judicial proceedings or otherwise as the Trustees being advised by counsel shall deem most expedient in the interest of the holders of the debentures.

In the event of the violation or threatened violation by the Company of any of the prohibitions or negative covenants of this Trust Agreement, the Trustees may, and upon the written request of the holders of 10% in principal amount of the debentures outstanding and upon being indemnified to its satisfaction for any liability which they might incur, shall immediately take such action by suit in equity or at law, or otherwise, as they may be advised by counsel, to prevent or redress such violation.

The holders of a majority in amount of the debentures from time to time outstanding hereunder shall have the right by instrument in writing delivered to the Trustees to direct the method and place of conducting any proceedings to be taken hereunder for the enforcement of this Trust Agreement or of said debentures.

Section 4. Any monies collected by the Trustees shall be applied as follows, at the date fixed by the Trustees for the distribution of such monies, upon presentation of several debentures, and stamping thereon the payment if only partially paid and upon the surrender thereof, if fully paid:

29. First: To the payment of costs and expenses of the Trustees including reasonable compensation to themselves, their agents, attorneys and counsel.

Second: In case the principal of the income debentures shall not have become due, to the payment of the interest in default in the order of the maturity of the installments



of such interest with interest on the overdue installments at the rate of four per cent (4%) per annum; such payments to be made ratably to the persons entitled thereto without discrimination or preference.

Third: In case the principal of the debentures shall have become due by declaration or otherwise, to the payment of the whole amount then owing or unpaid upon the outstanding debentures for principal and interest with interest at the rate of four per cent (4%) per annum on the overdue principal and installments of interest; in case such money shall be insufficient to pay the same in full, then to the payment of such principal and interest without preference or priority of principal over interest, or of interest over principal, or of any installment of interest over any other installment of interest, ratably to the aggregate of such principal and accrued and unpaid interest.

Section 5. No holder of any income debenture issued hereunder shall have the right to institute any action or proceeding in equity or at law upon ~~said debenture or debentures~~, or for the enforcement of any of the terms of this Trust Agreement, unless and until such holder shall have previously given to the Trustees written notice of a default of the Company in the performance of one or more of the stipulations of said debentures or of this Trust Agreement and its continuance as hereinbefore provided, and also unless or until the holders of twenty-five per cent (25%) (or in case of the prohibitions or negative covenants hereof, the holders of 10% as hereinabove provided) in principal amount of the debentures outstanding shall have made written request of the Trustees and shall have offered to said Trustees indemnity to their satisfaction against the costs, expenses and liabilities to be incurred by said Trustees, and shall have afforded to the Trustees a reasonable opportunity to exercise the powers herein granted to enforce this Trust Agreement, and the Trustees shall have refused or unreasonably delayed to comply with such request.

Provided, however, that nothing in this Trust Agreement shall affect or impair the obligation of the Company, which is unconditional and absolute, to pay at the date of maturity therein expressed the principal of the debentures to the respective holders thereof, or affect or impair the right of action of such holders to enforce such payment, subject only to the prior right of the Trustees, if exercised

promptly in accordance with the terms of this Trust Agreement.

Section 6. All remedies specifically conferred on the Trustees under this Trust Agreement shall be deemed cumulative and not exclusive and no delay or omission of the Trustees or of any holders of any of the debentures to exercise any right or power accruing upon any default shall impair any such right or power or be construed as a waiver of any such default or any acquiescence therein.

#### Article V.

##### Power to Amend Trust Agreement.

The Company and the Trustees may, from time to time, and at any time, enter into such agreements supplemental hereto, or amendatory hereof as shall be deemed by them necessary or desirable for the purpose of curing any ambiguity or of curing, correcting or supplementing any defective or inconsistent provisions contained herein or in any supplemental agreement, or for any other purpose not substantially inconsistent with the purposes of this agreement.

#### Article VI.

##### The Trustees.

The Trustees shall have no responsibility as to the validity of said debentures of the Company or as to their execution, and shall be held only to the exercise of reasonable care and diligence in carrying out the provisions of this Trust Agreement. The Trustees, may advise with counsel of their own selection (who may be counsel for the Company) and in taking any action or refraining therefrom under such advice shall incur no liability. For the current duties to be performed by the Trustees hereunder they shall receive such reasonable compensation as shall be agreed upon between them and the Company. In the event of any claim or probable default hereunder the Trustees shall be entitled, in addition, to be reimbursed by the Company for all proper outlays of whatever sort or nature to be incurred in or about this trust, in protecting the rights of the debenture holders, including counsel fees, and to receive from the Company a reasonable compensation for any duties that they may at any time perform in the dis-

charge of the same. All such fees, compensations and disbursements shall also constitute a first lien on all sums in its hands hereunder. They shall be entitled in the case of such claimed or probably default to advice of counsel in all matters concerning the trust. The Trustees may treat any holder of any debenture as the owner thereof, but shall not be bound to do so nor to take any action at his request unless the ownership thereof shall be otherwise shown to their satisfaction. The Trustees shall be under no obligation or duty to take any proceedings for the purpose of enforcing said debentures of this Trust Agreement unless they shall be reasonably indemnified against any liability in respect thereof, nor shall it be any part of the Trustee's duties to keep themselves advised or informed as to the performance of any of the Company's covenants or of any suit at law or in equity which the Trustees may institute against the Company in consequence of any such default; but the Trustees shall have the right to take whatever action to them may seem advisable to enforce said debentures of this Trust Agreement for the protection of the holders of all of said Debentures. The Trustees shall have the right to acquire and own debentures of this issue with the same rights which they would have were they not Trustees.

The Trustees, or any Trustee hereafter appointed may resign the Trust hereby created upon giving ninety (90) days notice in writing to the Company by mail, or such shorter notice as the Company may accept. The Trustees may be removed at any time by an instrument in writing signed by the holders of a majority in principal amount of the debentures then outstanding, and filed with such Trustees, subject to the right of the Trustees to receive reasonable compensation for the services and reimbursement of their costs and expenses. In the event of the resignation or removal of the Trustees, their successor may be designated by an instrument in writing signed by the holders of a majority in principal amount of the debentures then outstanding, or in the event that such designation be not made by the debenture holders within a period of ninety (90) days from the date of the resignation or removal, a successor Trustee may be named by the Company.

31 Any new Trustee appointed hereunder shall execute, acknowledge and deliver to the Trustee last in office and also to the Company, an instrument in writing accept-

ing such appointment hereunder, and shall thereupon become invested without further act or writing with all the rights, powers, trusts, duties and obligations of the Trustee hereunder with like effect as if originally named as Trustee hereunder.

Should any instrument in writing from the Company or from the Trustees last in office be required by any new Trustee or Trustees for more fully and certainly vesting in and confirming to such new Trustee such rights, powers and duties, any and all such instruments in writing shall on request be made, executed, acknowledged and delivered.

## Article VII.

### Successors and Assigns.

For every purpose of this Trust Agreement the terms, "The Company" includes and means The John Kelley Company and also its successors and assigns, including any corporation with or into which it may be consolidated or merged, or to which it may sell its properties as an entirety for the purpose of reincorporation. The word "Trustees" shall mean the Trustees for the time being, whether original or successor.

Mabel K. Ronald and Roy F. Kelley accept the trusts by this Trust Agreement declared and provided and agree to perform the same upon the terms and conditions herein set forth.

In Witness Whereof, The John Kelley Company has caused this instrument to be executed and acknowledged by its President or a Vice-President and its corporate seal to be hereunto affixed, attested by the signature of its Secretary or an Assistant-Secretary, and Mabel K. Ronald and Roy F. Kelley have caused this instrument to be executed and acknowledged by them.

The John Kelley Company,

By (Signed) Mabel K. Ronald,

*President.*

(Corporate Seal)

Attest:

(Signed) Roy F. Kelley,  
*Secretary.*

(Signed) Mabel K. Ronald,

(Signed) Roy F. Kelley,

*Trustees.*

32

## EXHIBIT "G"

No. 49

Shares

Incorporated under the laws of the State of Indiana

Non-assessable

The John Kelley Company

Marion, Indiana

Capital Stock \$450,000.00

Common Stock \$150,000.00

Preferred Stock \$300,000.00

Shares \$100.00 Par Value

Shares \$100.00 Par Value

This Certifies That

is the owner of \_\_\_\_\_ fully paid and non-assessable shares, of the par value of One Hundred (\$100.00) Dollars each, of the Preferred Capital Stock of The John Kelley Company, transferable in person, or by attorney, upon surrender of this Certificate properly endorsed.

The Preferred Stock of this Corporation shall have as against the Common Stock a first lien on the assets of the Corporation, subject, however, to the rights of creditors, and shall be entitled each year out of the surplus and net profits of the Corporation to a fixed dividend of six (6%) per cent, payable semi-annually on the first days of January and July, and before any dividends shall be set apart or paid on the Common Stock. The dividends on the Preferred Stock shall be cumulative so that, if for any year dividends amounting to six per cent shall not be paid on the Preferred Stock, the deficiency shall be a charge upon the net earnings of the Corporation and be paid subsequently before any dividend shall be set apart or paid upon the Common Stock; after which, the remaining surplus and profits shall belong to the Common Stock. In the event of liquidation of the Corporation; the assets shall first be applied in liquidation of claims of creditors, then of the Preferred Stock at par and six (6%) per cent cumulative annual dividends, after which, the remaining assets shall be distributed to the holders of the Common Stock. The Preferred Stock, or any part thereof, may be redeemed or retired, at the option of the Company, at any semi-annual dividend paying period, at the price of \$102.00 per share, together with the unpaid dividends thereon, if any, by giving to the holder or holders thereof, a notice in



writing thirty (30) days in advance of said dividend paying period, of the Company's exercise of said option to redeem, and, thereafter, such Preferred Stock shall cease to be entitled to dividends upon tender of said redemption price and accrued dividends. The Preferred Stock shall be at all times entitled to all of the rights and subject to all of the restrictions provided by the laws of the State of Indiana relating to Preferred Stock.

In Witness Whereof, the said Corporation has caused this Certificate to be signed by its President, its Secretary, and its Treasurer and its Corporate Seal to be hereunto affixed, this ..... day of ....., 19.....

(Seal)  
Attest:

.....  
President.

.....  
Secretary.

.....  
Treasurer.

Shares 100 Each

33

Certificate  
for

.....  
Shares  
of the  
Preferred  
Stock

The John Kelley Co.  
Marion, Indiana  
Issued To

.....  
Date

For Value Received, ..... hereby sell, assign and transfer unto .....

..... Shares of the  
Preferred Stock represented by the within Certificate,  
and do hereby irrevocably constitute and appoint  
..... Attorney to  
transfer the said Stock on the books of the within named

Corporation with full power of substitution in the premises.

Dated \_\_\_\_\_, 19\_\_\_\_.

In presence of \_\_\_\_\_

(In right-hand margin) Notice: The signature of this assignment must correspond with the name as written upon the face of the Certificate, in every particular, without alteration or enlargement, or any change whatever.

34 THE TAX COURT OF THE UNITED STATES.

(Filed Jan. 15, 1943.)

John Kelley Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 109088. Promulgated January 15, 1943.

Petitioner in 1937 issued "20 year 8% income debentures," having a maturity date, bearing interest to be paid out of earnings and not cumulative, subordinate to the claims of all creditors, superior to the rights of stockholders, subject to certain procedure for collection in event of designated defaults as specified in the trust agreement, and holders having no right to participate in management of corporation. Part of the "debentures" was issued on subscription and the balance was issued in exchange for all of petitioner's outstanding preferred stock, which was retired. *Held*, payments made to debenture holders are deductible as interest.

Frank J. Albus, Esq., for the petitioner.

John D. Kiley, Esq., for the respondent.

The respondent has determined against petitioner income tax deficiencies for the calendar years 1937, 1938, and 1939 in the amounts of \$569.06, \$1,980, and \$1,980, respectively, and an excess profits tax deficiency in the amount of \$360 for 1937.

The only issue presented is whether the payments on corporate debentures were interest on indebtedness or dividends on stock.

Findings of Fact.

Substantially all the facts are stipulated and are hereby found accordingly. Those facts hereafter appearing which

are not from the stipulation are facts found from the record made at the hearing.

Petitioner is an Indiana corporation, organized in 1907 and reorganized in 1930, and has its principal place of business in Marion, Indiana. It is engaged in a retail furniture business. Its income tax returns for the calendar years 1937, 1938, and 1939 were prepared from books kept on the accrual basis, the taxable profit on installment sales being computed on the installment basis, and were filed with the collector of internal revenue at Indianapolis, Indiana.

On January 1, 1937, the petitioner had authorized as capital stock 1,500 shares of common stock at no par value and 3,000 shares of preferred stock at \$100 par value, of which 1,110 shares of common stock and 1,124 shares of preferred stock had been issued and were outstanding. Roy F. Kelley, individually, owned 567 shares of common stock and 628 shares of preferred stock, and, as trustee for Mabel K. Ronald, he owned 543 shares of common stock and 496 shares of preferred stock. Mabel K. Ronald, who died May 30, 1940, was a sister of Roy F. Kelley.

During the month of January 1937 Roy F. Kelley transferred the 628 shares of preferred stock and 171 of the common shares owned by him in his own right: 50 shares of preferred to Mabel K. Ronald, as trustee for her daughters, Ruth Stevens Korper and Mary Louise Stogsdill; 289 shares of preferred to Mabel K. Ronald as trustee for Ruth Stevens Korper; 289 shares of preferred to Mabel K. Ronald as trustee for Mary Louise Stogsdill; and the 171 shares of common stock to his wife, Birdena Kelley. It was provided in the above three trusts, however, that Birdena Kelley should receive the income from the 628 shares of preferred stock during her lifetime.

On January 11, 1937, a special meeting of the board of directors of the petitioner corporation was held and a plan of recapitalization was adopted. Following that meeting and on the same date the shareholders of the corporation held a special meeting and approved the resolution adopted by the board of directors. Under this resolution the authorized issue of 1,500 shares of common stock of no par value was changed to 4,500 shares of common stock with a par value of \$100 per share and then increased to 6,000 shares. The resolution also authorized the issue of "income debenture bonds" aggregating the sum of \$250,000,

bearing interest at the rate of 8 per cent per annum, and the execution of a trust agreement setting forth the terms and conditions upon which said debenture bonds were issued and the power and duties of the trustees. Under the resolution the income debenture bonds would be offered by the trustees in exchange for the issued and outstanding 1,124 shares of the preferred stock on the basis of \$102 in face value of debentures for each share of said preferred stock; and, for the purpose of raising additional capital to expand the business of the corporation "in the field of finance", the trustees were to offer any and all unissued debenture bonds for sale at face value to the shareholders of the corporation. The directors meeting was attended by the three directors, Mabel K. Ronald, Roy F. Kelley, and Mary Louise Stogsdill, and the holders of the entire capital stock of the corporation, Mabel K. Ronald and Roy F. Kelley, were present at the meeting of the shareholders.

The trust indenture dated January 1, 1937, was entered into by the petitioner corporation through its president, Mabel K. Ronald, and secretary, Roy F. Kelley, with the trustees, Mabel K. Ronald and Roy F. Kelley. None of the income debenture bonds were issued prior to July 1, 1937. On that date Roy F. Kelley, as trustee for Mabel K.

Ronald, delivered to the petitioner 496 shares of preferred stock, and coincidental therewith there were delivered to Roy F. Kelley, as trustee for Mabel K. Ronald, \$50,592 face amount of the said bonds. On the same date, Mabel K. Ronald, as trustee for Ruth Stevens Korper and Mary Louise Stogsdill, delivered to the petitioner 628 shares of preferred stock, and coincidental therewith there were delivered to Mabel K. Ronald, as trustee for the same beneficiaries, \$64,056 face amount of the income debenture bonds. On July 1, 1937, Mabel K. Ronald and Birdena Kelley subscribed for \$24,408 and \$10,944, respectively, of the said bonds. These amounts were carried against them in open accounts on the books of the petitioner and were later wiped out by the credit of dividends received by them on common stock. In the case of Mabel K. Ronald the dividends so credited were on the common stock held for her by Roy F. Kelley, as trustee, while in the case of Birdena Kelley the said dividends were on the 171 shares of common stock which had been transferred to her by Roy F. Kelley in January of 1937.

Petitioner, on December 10, 1937, filed articles of amend-

ment of its articles of incorporation with the Secretary of State of Indiana, which showed the total number of shares of its capital stock to be 3,000 shares of preferred stock having a par value of \$100 each and 6,000 shares of common stock having a par value of \$100 each.

On December 15, 1937, 1,110 outstanding shares of common stock of the petitioner were owned, 396 shares by Roy F. Kelley; 171 shares by Birdena Kelley; and 543 shares by Roy F. Kelley, as trustee for Mabel K. Ronald. A cash dividend of \$55 per share was paid on 1,110 shares on December 15, 1937, after which a common stock dividend of  $\frac{3}{4}$  shares for each share of common stock held was declared and paid by petitioner.

During the periods of July 1 to December 31, 1937; January 1 to December 30, 1938; and January 1 to December 31, 1939, the petitioner had outstanding "income debenture bonds" of the face amount of \$150,000, in respect of which \$6,000, \$12,000, and \$12,000 for each period, respectively, were set up on the books of petitioner as accrued interest thereon. The amounts so accrued were paid and were claimed by petitioner as deductions in computing its taxable net income for the respective calendar year 1937, 1938, and 1939. These deductions were disallowed by the respondent.

On the petitioner's books the "income debentures" were referred to as "stocks," "bonds," and "notes." Charges were entered in an account which was headed "accrued interest, income debentures." The petitioner in its capital stock tax returns for 1938 and 1939 listed "debenture" and "debenture notes," respectively, as capital stock. They were not reflected as indebtedness in the balance sheets appearing in the income and excess profits tax returns filed by petitioner for 1937, 1938, and 1939, but appear under the heading "Capital Stock: Debenture Notes." The board of directors annually adopted corporate resolutions authorizing the payment of "interest" on the "income debenture bonds" or "debenture notes." On most of the checks, drawn for the "interest" on the "income debentures" to the holders thereof, the nature of payment was described to be for "Interest, income debenture stock."

On January 1, 1937, the assets of petitioner totaled \$963,807.57 and its liabilities exclusive of common and preferred stock totaled \$75,817.74. On December 31, 1937, its total



assets were \$982,221.08 and its total liabilities exclusive of common stock and the debentures were \$46,158.19. —

The trust indenture set out the form of debenture to be issued, which was substantially followed, and the debentures in controversy, in so far as material, read as follows:

THE JOHN KELLEY COMPANY, an Indiana corporation, for value received, promises to pay to the bearer on the 31st day of December, 1956, the sum of ONE THOUSAND DOLLARS (\$1,000) in lawful money of the United States of America at the office of the Company in Marion, Indiana, and to pay interest thereon in like lawful money, out of the net income of the Company, at the rate of 8% per annum, payable annually on the 31st day of December of each year, at the office of the Company in Marion, Indiana, on presentation of this Debenture for endorsement of payment thereon, conditioned, however, upon the net income of the Company being sufficient during any interest period to pay the amount due as interest, in accord with the terms and provisions hereof. The interest on this Income Debenture shall not be cumulative.

If any of the events of default specified in the trust agreement shall occur, all debentures outstanding hereunder may be declared to be due and payable in the manner and with the effect provided in the trust agreement.

In the payment of their claims, all creditors, other than the stockholders of the Company, shall rank superior to the holders of this income debenture, but all holders of this income debenture shall rank *pari passu* with each other and superior to the stockholders of the corporation with respect to their share stock.

Article IV of the trust indenture set forth "Default and Remedies," and the first two sections thereof designated "default" as follows:

Section 1. If one or more of the following events of default happen, viz; (a) if default be made in the punctual payment of any installment of interest on any outstanding debenture or debentures or (b) if default be made in the observance or performance of any of the terms of said debentures or of this Trust Agreement, and any such last named default shall

continue for a period of two (2) years after written notice thereof shall have been given to the Company by the Trustees (whose duty it shall be to give such notice at the request in writing of at least twenty-five per cent (25%) in principal amount of the debentures at the time outstanding hereunder), then and in every such case, the Trustees may, and upon the written request of the holders of twenty-five per cent (25%) in principal amount of the debentures then outstanding hereunder shall declare the principal of all debentures then outstanding hereunder to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, anything in this Trust Agreement or in said debentures contained to the contrary notwithstanding.

This provision, however, is subject to the conditions that if at any time after the principal of said debentures shall have been so declared due and payable, and before any judgment or decree for the payment of monies due shall have been entered, all arrears of interest upon all the debentures shall have been duly paid and all defaults shall have been made good, and all the stipulations of said debentures and of this Trust Agreement shall have been fully performed by the Company, then, and in every such case, the holders of a majority in principal amount of the debentures then outstanding, by written notice to the Company and to the Trustees, may waive such default and its consequence and rescind such declaration; but no such waiver or rescission shall extend to or affect any subsequent default or impair any right consequent thereon.

Section 2. The company covenants that (a) in case default shall be made in the punctual payment of any installment of interest on any outstanding debenture or debentures and such default shall have continued for a period of two (2) years; or (b) in case default shall be made in the payment of the principal of any such debenture or debentures when the same shall become payable, whether upon maturity or upon call or declaration as provided in this Trust Agreement, then upon demand of the Trustees the Company will pay to the Trustees for the benefit of the holders of the debentures issued hereunder and then

outstanding, the whole amount which then shall have become due and payable on all such debentures then outstanding and in addition thereto such further amount as shall be sufficient to cover the costs and expenses of collection, including a reasonable compensation to the Trustees, their agents, attorneys and counsel, and any expenses or liability incurred by the Trustees hereunder. In case the Company shall fail forth-with to pay such amount on such demand, the Trustees in their own names and as Trustees of an express trust shall be entitled and empowered to institute such action or proceeding at law or in equity, as may be advised by counsel, for the collection of the sums so due and unpaid and may prosecute any such action or proceeding to judgment or final decree and may enforce any such judgment or decree in the manner provided by law.

The trust indenture provided certain procedure to be followed by the trustees and debenture holders in enforcing payment of the interest and principal, in case of default by the petitioner. In one provision the petitioner pledged that all of its property was free of mortgage and no lien or any other encumbrance would be placed upon it as long as any of the debentures were outstanding. It was also provided that the debentures were subordinate to the claims of petitioner's creditors but had priority over the claims of the stockholders. The holders of the debentures were not given the right to participate in the management of the business.

#### OPINION.

TURNER, *Judge*: If the debentures have created an indebtedness the payments to the holders thereof are interest and deductible as expense, but if they are in fact capital stock the payments are dividends and not deductible.

Similar questions have been before this tribunal and other courts, and with each one it was necessary to consider all of the facts and circumstances in the particular case in order to determine if the relationship was that of a stock ownership or of debtor and creditor. In some cases the determining characteristic has been one factor, while in other cases it has been another. No one factor is neces-

sarily controlling. *Commissioner v. Schmoll Fils, Associated, Inc.*, 110 Fed. (2d) 611 (C.C.A., 2d Cir., 1940).

The determining factors are usually listed as the name given to the certificates, the presence or absence of maturity date, the source of the payments, the right to enforce the payment of principal and interest, participation in management, status equal to or inferior to that of regular corporate creditors, and intent of the parties. Applying the test of these determining characteristics, we conclude petitioner should prevail.

Though at different times the petitioner might have called the "debentures" "stock," at all times the payments thereon, whether on the books, in the minutes, or in the income tax returns, were referred to as "interest." It is true that the interest was to be paid out of "net income," but that in itself is not decisive. *H. R. DeMilt Co.*, 7 B. T. A. 7. In the event of default the trustees and debenture holders were entitled to declare, in a designated process, the debentures immediately due and payable and to institute suit thereon. The fact that the debentures were subordinated to the rights of all creditors but were prior to those of the stockholders is not of itself conclusive against their classification as indebtedness. *O. P. P. Holding Corporation*, 30 B. T. A. 337; *affd.*, 76 Fed. (2d) 11 (C. C. A. 2d Cir.). The debenture holder did not have the right to participate in the management of the corporation. It is apparent that the holders of the preferred stock, in exchanging the stock for "20 year 8% income debentures," preferred the debtor-creditor status of debenture holders to that of stockholders, and stockholders have the right to change to the creditor-debtor basis, though the reason may be purely personal to the parties concerned. *Commissioner v. Procter Shop, Inc.*, 82 Fed. (2d) 702 (C. C. A., 9th Cir.), *affirming* 30 B. T. A. 721.

In computing the surtax on undistributed profits the respondent increased the dividend paid credit claimed by petitioner in the returns for the years 1937, 1938, and 1939 in the amounts of \$6,000, \$12,000, and \$12,000, respectively, by reason of having determined the said amounts were dividends and not interest. The dividend paid credit as to each of the years should be reduced by a corresponding amount.

*Decision will be entered under Rule 50.*

40

THE TAX COURT OF THE UNITED STATES.

(Caption—109088)

DECISION.

(Entered Feb. 19, 1943.)

Pursuant to the findings of fact and opinion of the Court promulgated January 15, 1943, the respondent herein on February 2, 1943 filed a recomputation of tax, and on February 17, 1943 the petitioner filed an agreement to such recomputation. It is, therefore,

Ordered and Decided: That there are no deficiencies in income tax for the calendar years 1937, 1938 and 1939, and that there is no deficiency in excess-profits tax for said year 1937.

(Signed) Bolon B. Turner,

(Seal)

Judge.

Entered Feb. 19, 1943.

41 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

Guy T. Helvering, Commissioner of  
Internal Revenue,

*Petitioner on Review,*

*vs.*

The John Kelley Company,

*Respondent on Review.*

B. T. A. No. 109088.

PETITION FOR REVIEW.

(Filed May 18, 1943.)

Guy T. Helvering, United States Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions the United Circuit Court of Appeals for the Seventh Circuit to review the decision entered by The Tax Court of the United States on February 19, 1943, whereby it is ordered and decided that there are no deficiencies in income tax for the calendar years 1937, 1938 and 1939, and that there is no deficiency in excess-profits tax for said year 1937. The taxpayer, The John Kelley Company, filed its corporation income and excess-profits tax returns for the calendar years 1937, 1938 and 1939 with



the Collector of Internal Revenue for the District of Indiana, whose office is located at Indianapolis, Indiana, and within the judicial circuit of the United States Circuit Court of Appeals for the Seventh Circuit. The Commissioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

(Sgd.) Samuel O. Clark, Jr.,  
Assistant Attorney General.

(Signed) J. P. Wenchel,  
RLW

J. P. Wenchel,  
Chief Counsel, Bureau of  
Internal Revenue.

JMM:sw 5-12-43

42 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

\* \* (Caption—109088) \* \*

### STATEMENT OF POINTS.

(Filed May 18, 1943.)

Comes now Guy T. Helvering, Commissioner of Internal Revenue, the petitioner on review herein, by and through his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the following errors which he intends to urge on review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of The Tax Court of the United States entered herein on February 19, 1943:

1. The Tax Court of the United States erred in holding that the amounts of \$6,000, \$12,000, and \$12,000 for the respective taxable years 1937, 1938 and 1939, claimed as deductions by taxpayer as interest accrued and paid upon its so-called 20-year 8% income debentures, represented "interest paid or accrued within the taxable year on indebtedness" within the meaning of Section 23(b) of the Revenue Acts of 1936 and 1938, and are, therefore, allowable as deductions in the respective taxable years; and in overruling the action of the Commissioner in disallowing such deductions.

43 2. The Tax Court of the United States erred in failing to hold that the designated 20-year 8% debentures

represented proprietary interests rather than indebtedness and hence the so-called interest on the designated debentures is in reality a dividend which cannot be deducted in computing net income.

3. The Tax Court of the United States erred in holding that there are no deficiencies in income tax for the calendar years 1937, 1938 and 1939, and that there is no deficiency in excess-profits tax for said year 1937.

4. The Tax Court of the United States erred in failing to hold that there are deficiencies in income tax for the years 1937, 1938 and 1939 in the amounts of \$596.06, \$1,980, and \$1,980, respectively, and that there is a deficiency in excess-profits tax in the amount of \$360 for the year 1937.

5. The Tax Court of the United States erred in that its opinion and decision are not supported by the evidence and are contrary to law.

(Sgd.) Samuel O. Clark, Jr.,  
*Assistant Attorney General.*

(Signed) J. P. Wenchel,  
RLW

J. P. Wenchel,  
*Chief Counsel, Bureau of  
Internal Revenue.*

JMM:sw 5-12-43

44 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.  
\* \* (Caption—109088) \* \*

**NOTICE OF FILING PETITION FOR REVIEW AND  
STATEMENT OF POINTS.**

(Filed May 25, 1943.)

To: The John Kelley Company,  
Second & Washington Streets,  
Marion, Indiana,  
Respondent on Review.

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of May, 1943, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review and statement of points by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition

for review and statement of points as filed is hereto attached and served upon you.

Dated this 18th day of May, 1943.

(Signed) J. P. Wenchel,

RLW

J. P. Wenchel,

*Chief Counsel, Bureau of  
Internal Revenue.*

Personal service of the above and foregoing notice, together with a copy of the petition for review and statement of points mentioned therein, is hereby acknowledged this 26th day of May, 1943.

The John Kelley Company,

By (Sgd.) Ray F. Kelley,

*Treas.*

JMM:sw 5-13-43

45 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

\* \* (Caption—109088) \* \*

# NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS.

(Filed May 18, 1943.)

The Tax Court of the United States. Filed May 21, 1943.

To: Frank J. Albus, Esquire,

Earle Building,

Washington, D. C.,

Counsel for Respondent on Review.

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of May, 1943, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review and statement of points by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review and statement of points as filed is hereto attached and served upon you.

Dated this 18th day of May, 1943.

(s) B. D. Gamble,

B. D. Gamble,

*Clerk, The Tax Court of the  
United States.*

Service of the above and foregoing notice, together with a copy of the petition for review and statement of points mentioned therein, is hereby acknowledged this 19th day of May, 1943.

(s) Frank J. Albus,  
*Counsel for Respondent on Review.*

46 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.  
\* \* (Caption—109088) \* \*

### DESIGNATION OF CONTENTS OF RECORD.

(Filed Sept. 17, 1943.)

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
  - (a) Petition.
  - (b) Amended answer.
3. Findings of fact and opinion and the decision of the Tax Court.
4. Petition for review and statement of points.
5. Notices of filing petition for review:
  - 5(a). Excerpt from transcript of hearing at Indianapolis, Indiana, on May 18, 1942, consisting of lines 9, page 33, to and including line 24, page 34.
- 47 6. Exhibits E, F, and G, which are attached to stipulation of facts, and stipulation filed December 5, 1942.
7. This designation.

(Sgd.) Samuel O. Clark, Jr.,  
SLY

Samuel O. Clark, Jr.,  
*Assistant Attorney General.*

(Signed) J. P. Wenchel,  
SLY

J. P. Wenchel,  
*Chief Counsel, Bureau of Internal Revenue.  
Attorneys for Petitioner on Review.*

*Order Enlarging Time.*

Service of a copy of the within designation of contents of record is hereby admitted this 13th day of September, 1943.

(Sgd.) Frank J. Albus,

*Attorney for Respondent  
on Review.*

## THE TAX COURT OF THE UNITED STATES.

\* \* (Caption—109088) \*

## ORDER ENLARGING TIME.

(Entered June 23, 1943.)

Upon motion of counsel for petitioner, it is

Ordered that the time for preparation, transmission and delivery of the record sur petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit is extended to August 16, 1943.

(Signed) J. E. Murdock,

*Presiding Judge.*

(Seal)

Dated: Washington, D. C.,  
June 23, 1943.

mhn

Now, Oct. 1, 1943 the foregoing order certified from the record as a true copy.

B. D. Gamble,

*Clerk, The Tax Court of the  
United States.*

(Seal)

## 49 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

\* \* (Caption—109088) \*

## ORDER.

(Filed Aug. 11, 1943.)

The Tax Court of the United States. Filed August 11, 1943.

For Cause Shown, It Is Ordered that the time within which to file the record on review in the above-entitled cause with this court be, and the same is, extended to and including Oct. 16, 1943.

It Is Further Ordered that the Clerk of this court is di-



rected to transmit to the Clerk of The Tax Court of the United States, a certified copy of this order.

Done at Chicago, Illinois, this 9th day of August, A. D. 1943.

William M. Sparks,  
*Judge, United States Circuit Court of  
Appeals for the Seventh Circuit.*

Now, Oct. 1, 1943 the foregoing order certified from the record as a true copy.

(Seal) B. D. Gamble,  
*Clerk, The Tax Court of the  
United States.*

50 UNITED STATES CIRCUIT COURT OF APPEALS

*For the Seventh Circuit.*

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten pages contain a true copy of order entered this day in Cause No. B. T. A. 109088, Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. The John Kelley Company, Respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this ninth day of August, A. D. 1943.

(S) Kenneth J. Carrick,  
(Seal) *Clerk of the United States Circuit Court  
of Appeals for the Seventh Circuit.*

51

## THE TAX COURT OF THE UNITED STATES

Washington.

Commissioner of Internal Revenue,  
*Petitioner,*

vs.

The John Kelley Company,  
*Respondent.*

Docket No. 109088.

## CERTIFICATE.

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 47, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 1st day of October, 1943.

(Seal)

B. D. Gamble,

*Clerk, The Tax Court of the  
United States.*

UNITED STATES CIRCUIT COURT OF APPEALS:

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify thatt he foregoing printed pages contain a true copy of the printed record, printed under my supervision and filed on the ninth day of December, 1943, in:

Cause No. 8426.

Commissioner of Internal Revenue,

*Petitioner,*

*vs.*

The John Kelley Company,

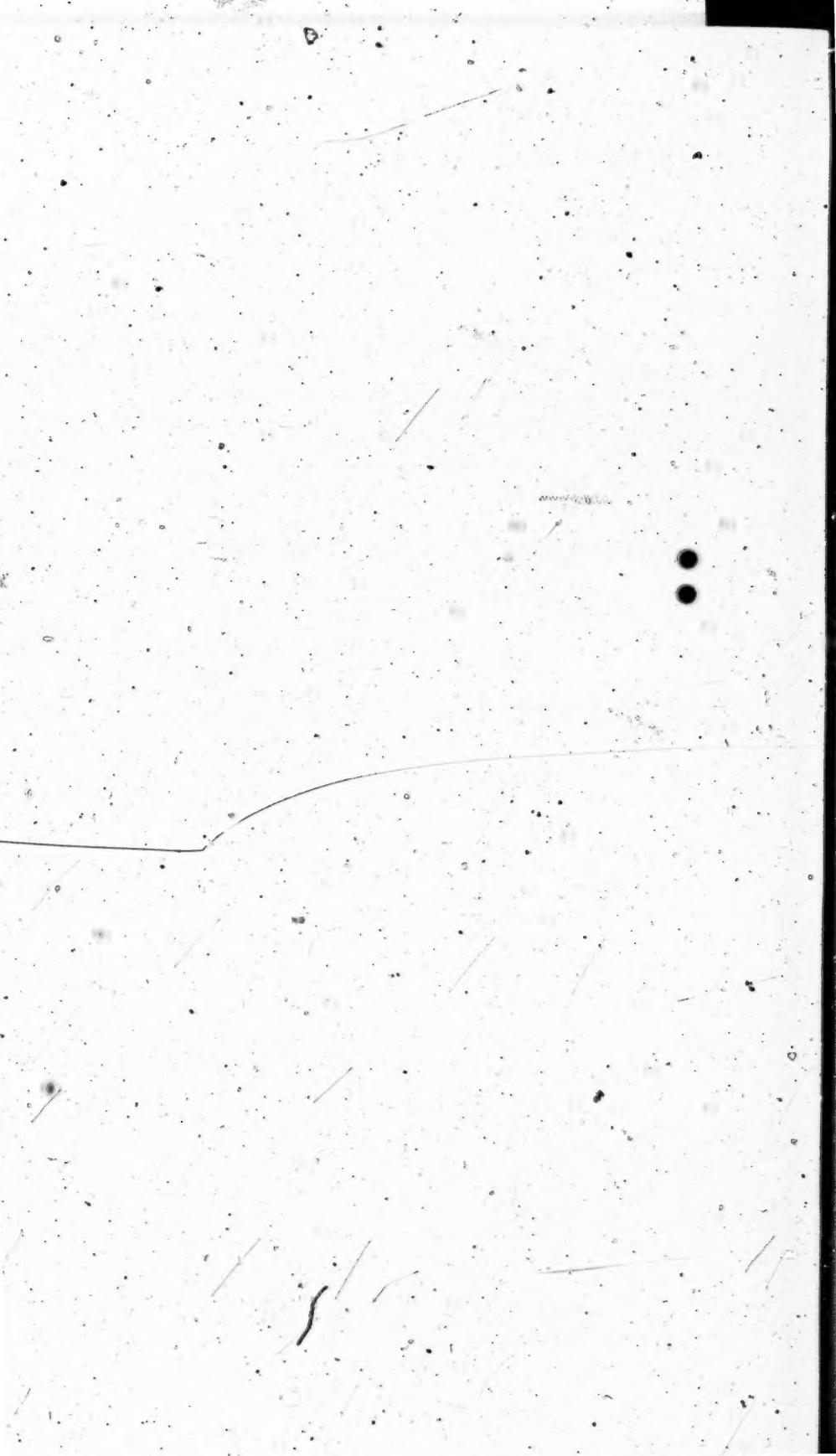
*Respondent.*

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 16th day of January, A. D. 1945.

(signed) Kenneth J. Carrick,  
*Clerk of the United States Circuit Court  
of Appeals for the Seventh Circuit.*

(Seal)



At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, held in the City of Chicago, and begun on the twenty-eighth day of September, in the year of our Lord one thousand nine hundred and forty-three and of our Independence, the one hundred and sixty-eighth.

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Commissioner of Internal Revenue,	}	Petition for Review of Decision of the Tax Court of the United States.
<i>Petitioner,</i>		
8426 <i>vs.</i>		
The John Kelley Company, <i>Respondent.</i>		

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And, to-wit: On the eleventh day of October, 1943, there was filed in the office of the Clerk of this Court, an appearance of counsel for Respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS,

For the Seventh Circuit. //

Cause No. 8426.

Commissioner of Internal Revenue,

*Petitioner,*

*vs.*

The John Kelley Company,

*Respondent.*

The Clerk will enter my appearance as counsel for Respondent.

Frank J. Albus,  
Earle Bldg.,  
Wash., D. C. 4.

Endorsed: Filed October 11, 1943. Kenneth J. Car-  
rick, Clerk.

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And afterwards, to-wit: On the twenty-third day of December, 1943, there was filed in the office of the Clerk of this Court, an appearance for counsel for Petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS,

For the Seventh Circuit.

Case No. 8426.

Commissioner of Internal Revenue,  
*Petitioner,*  
*vs.*

The John Kelley Company,  
*Respondent.*

The Clerk will enter our appearances as counsel for the Petitioner.

J. P. Wenchel, C.A.R.  
*Chief Counsel, Bureau  
of Internal Revenue.*

John M. Morawski, C.A.R.  
*Special Attorney, Bureau  
of Internal Revenue.*

Endorsed: Filed December 23, 1943. Kenneth J. Carrick, Clerk.

And afterwards, to-wit: On the third day of January, 1944, there was filed in the office of the Clerk of this Court, an appearance of counsel for Petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS.

For the Seventh Circuit.

Case No. 8426.

Commissioner of Internal Revenue,  
*Petitioner,*  
*vs.*

The John Kelley Company,  
*Respondent.*

The Clerk will enter our appearances as counsel for the Petitioner.

Samuel O. Clark, Jr.,  
*Assistant Attorney General.*

Sewall Key,  
Robert N. Anderson,  
Muriel Paul,  
*Special Assistants to  
the Attorney General.*

Endorsed: Filed January 3, 1944. Kenneth J. Carrick, Clerk.

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And afterwards, to-wit: On the fifteenth day of November, 1944, the following further proceedings were had and entered of record, to-wit:

Wednesday, November 15, 1944.

Court met pursuant to adjournment.

Before:

Hon. Evan A. Evans, Circuit Judge.

Hon. Otto Kerner, Circuit Judge.

Hon. Sherman Minton, Circuit Judge.

Commissioner of Internal Revenue,

8426

vs.

The John Kelley Company,

Respondent.

Petitioner,

} Petition for Review  
of Decision of the  
Tax Court of the  
United States.

Now this day come the parties by their counsel, and this cause comes on to be heard on the transcript of the record and the briefs of counsel, and on oral argument by Miss Maryhelen Wigle, counsel for petitioner, and by Mr. Frank J. Albus, counsel for respondent, and the Court takes this matter under advisement.

And afterwards, to-wit: On the twenty-first day of December, 1944, there was filed in the office of the Clerk of this Court, the Opinion of the Court, which said opinion is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS,

For the Seventh Circuit.

No. 8426.

OCTOBER TERM AND SESSION, 1944.

COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

vs.

THE JOHN KELLEY COMPANY,

*Respondent.*

Petition for Review  
of Decision of the  
Tax Court of the  
United States.

December 21, 1944.

Before EVANS, KERNER, and MINTON, *Circuit Judges*.

MINTON, *Circuit Judge*. The Commissioner of Internal Revenue determined deficiencies in income and excess profits tax against the taxpayer, the John Kelley Company for the calendar years 1937, 1938, 1939. The Tax Court refused to sustain the assessment, and the Commissioner has petitioned for review. The alleged deficiencies arose from the taxpayer's deduction of payments made on income debentures as interest on indebtedness. The Commissioner contends that the payments were dividends within the meaning of section 115 (a) and not interest within the meaning of section 23 (b) of the Revenue Act of 1936, Chap. 690; 49 Stat. 1648; 26 U. S. C. A. §§ 23 (b) and 115 (a).

The sole question presented is whether the payments were interest. There is no dispute as to the facts, and the evidence in the record before us is documentary. Thus a question of law is presented, and its review is clearly authorized by statute. 44 Stat. 110; 26 U. S. C. A. § 1141 (c) (1). *Commissioner v. Meridian & Thirteenth Realty Co.*, 132 F. 2d 182, 188.

In deciding cases of this kind the various provisions of the instrument evidencing the obligation in the light of the surrounding circumstances in each case determine whether the relationship created is proprietary or that of debtor-creditor. Each case stands on its own feet. As we said in *Commissioner v. Meridian & Thirteenth Realty Co.*, *supra* at p. 185:

"Precedents are abundant, but because of the widely-varying fact bases upon which the conclusions are reached, they serve only as guides. Many are the criteria named to aid in the determination. Sometimes a particular one is called decisive,—or the most important test,—sometimes a combination of the elements sways the determination."

The following are the pertinent facts. The taxpayer is an Indiana corporation operating a retail furniture store. Its books were kept on an accrual basis. On January 1, 1937, taxpayer had authorized 1,500 shares of no par common stock and 3,000 shares of 6% cumulative preferred stock of \$100 par value, of which 1,110 of the common and 1,124 of the preferred were outstanding. The business was a closely held family corporation. All the outstanding common stock was owned by Roy Kelley, his wife, and his sister, Mabel Kelley Ronald. The latter was president of the company, and Roy Kelley was secretary. The preferred stock was all owned either individually or as trustee by Roy Kelley and his sister.

On January 11, 1937, the corporation adopted resolutions authorizing a so-called plan of reorganization. Under this plan, the common stock was changed to \$100 par value and increased to 6,000 shares. Twenty year "income debenture bonds" aggregating \$250,000 and bearing interest at 8% per annum were authorized. At the same time, and as part of the same scheme, a trust agreement was executed, setting forth the terms upon which the debentures were issued and outlining the powers and duties of the trustee. The trust agreement was signed on behalf of the company by its president, Mabel K. Ronald, and by her brother, Roy Kelley, as secretary. Then they moved to the other side of the table and signed the agreement as trustees. It was all a little arrangement between them. The same people represented both sides of the transaction. This is enough to inspire hesitation in calling it a bona fide trust agreement.



Under the scheme the "income debentures" were exchanged for the preferred stock at \$102 per share. Also, for the purpose of raising additional capital to expand the business "in the field of finance," as the resolution recited, the trustees were authorized to sell additional debentures at par, but *only* to the shareholders of the corporation. Mabel K. Ronald and Berdina Kelley, the wife of Roy Kelley, subscribed for \$24,408 and \$10,944, respectively, of the debentures. They did not pay cash for these debentures, but the subscriptions were charged to the purchasers on the books of the company and were later wiped out by the credit of dividends paid on the common stock held by each.

The dividends of this little corporation, even in these slack business years, were exceptionally good. A cash dividend of \$55 per share and a stock dividend of  $3\frac{1}{2}$  shares for one was paid on the common stock in 1937. Attention is called to the fact that Mabel K. Ronald who, as a trustee, was obligated to promote the sale of the debentures in order to raise additional capital to expand the business, herself bought some debentures without paying cash for them. Such a transaction did not put a penny of new money into the treasury of the corporation. It may further be observed that in a slack business year such as 1937 a corporation which was able to pay \$55 a share cash dividends and a stock dividend of  $3\frac{1}{2}$  shares for one, ought not to have had to pay 8% interest on its debentures. In our opinion, the 8% rate of interest was not fixed with any regard to the money market in 1937 but was fixed to drain off 8% interest on debentures which had retired 6% stock.

The 8% interest on the debentures was payable *only* out of the *net income* of the company. If there was no income, there were no payments, and *defaulted payments did not accumulate*. At liquidation or insolvency, the debenture holders were superior in rank only to the common stockholders, just as were the former preferred stockholders. All other creditors had preference. The preference of the debenture holders over the stockholders meant nothing, because all the debentures were held by stockholders, either individually or as trustees. The debenture holders had no voice in management. That, too, was of little moment, for the same reason.

On the books of the company the income debentures were referred to variously as "stocks," "bonds," and "notes."

In the capital stock tax returns for 1938 and 1939, the "debentures" and "debenture notes" were listed as capital stock. They were not reflected as indebtedness in the balance sheets appearing in the income and excess profits tax returns filed by the respondent for 1937, 1938, and 1939, but appeared under the heading, "Capital Stock: Debenture Notes." On most of the checks drawn to make the income payments on the debentures, the nature of the payment was described as "Interest, income debenture stock."

While the name given to the document is not controlling<sup>1</sup> it may be persuasive, if consistently used, as indicative of the intent and purpose of the corporation issuing the document. On the other hand, if there has been inconsistent use of such names, it may be considered in determining whether the corporation did what it professed to do.

In 1937, \$6,000 was paid as income on the debentures and \$12,000 was paid in each of the years 1938 and 1939. The taxpayer deducted these payments as interest on indebtedness pursuant to section 23 (b).

From this statement of the facts, it becomes apparent that these debentures had every aspect of preferred stock except one: they had a definite maturity date. It is not, however, unusual today for preferred stock to have a maturity or retirement date. In fact, such is authorized by Indiana corporation law. Burns Ind. Stat. Anno. (1933) § 25-205. *Commissioner v. Meridian & Thirteenth Realty Co.*, *supra* at p. 186, note 6. The presence of a maturity date, however, is not controlling. *Kentucky River Coal Corp. v. Lucas*, 51 F. 2d 586, 588, *aff.* 63 F. 2d 1007. Especially is this true where, as in the case at bar, debentures were unsecured and were inferior to the claims of any creditor.

The scheme to convert the preferred stock into debentures left the debentures resembling preferred stock rather than indebtedness. "In the business world 'interest on indebtedness' means compensation for the use or forbearance of money." *Deputy v. du Pont*, 308 U. S. 488, 498, 60 S. Ct. 363, 84 L. Ed. 416. The taxpayer "hired" no money here. Its owners merely swapped papers and wound up in relatively the same position.

1. "Law of Federal Income Taxes," Merten, §26.10; *Commissioner v. Schmoll Fils Associated, Inc.*, 110 F. 2d 611, 613; *Jewel Tea Co., Inc. v. United States*, 90 F. 2d 451, 452.

Stockholders take the risks of a business while creditors must be paid whether the corporation has a net income or not. The distinguishing feature of one is risk, and of the other, security. In the case at bar, the debenture owners were not to be paid in any event but were to be paid only after all other creditors were paid; and the "interest" on the debentures was to be paid only if sufficient net income was earned within the period. Such debentures obviously evidenced risk capital, not creditor capital. In short, it was all a matter of accounting hocus-pocus, guided by a little too clever legal planning which eventuated in a rather flimsy scheme to avoid paying of taxes. As far as we are concerned, it will not succeed.

No case has been decided where the facts so clearly characterized the document as stock. A consideration of cases in the Circuit Courts of Appeals and the District Courts discloses none where noncumulative payments, payable-out of earnings only, have been held to be interest.<sup>2</sup> Every provision of these debentures is a frequent and authorized clause familiar to preferred stock. Viewing this transaction from any angle, it has all the aspects of an issue of restricted preferred stock. In our opinion, payments made on the so-called "debentures" were dividends within the meaning of section 115 (a) and not interest on indebtedness.

The judgment of the Tax Court is

REVERSED.

Endorsed: Filed December 24, 1944. Kenneth J. Carrick, Clerk.

2. *Helvering v. Richmond, F. & P. R. Co.*, 90 F. 2d 371; *Commissioner v. Palmer, Stacy-Merrill, Inc.*, 111 F. 2d 809; *Arthur R. Jones Syndicate v. Commissioner*, 23 F. 2d 833; *Commissioner v. O. P. P. Holding Corporation*, 76 F. 2d, 11; *Commissioner v. H. P. Hood & Sons, Inc.*, 141 F. 2d 467; *Commissioner v. J. N. Bray Co.*, 126 F. 2d 612; *Commissioner v. Proctor Shop, Inc.*, 82 F. 2d 792; *United States v. Title Guarantee & Trust Co.*, 133 F. 2d 900; *Diamond Calk Horse Shoe Co. v. United States*, 40-2 USTC ¶9641, app. dismissed, 116 F. 2d 284. The only holding to the contrary is a Tax Court memorandum decision, *S. Glaser & Sons, Inc. v. Commissioner*, CCH Dec. 14,006 (M) 6.

And on the same day, to-wit: On the twenty-first day of Decémber, 1944, the following further proceedings were had and entered of record, to-wit:

Thursday, December 21, 1944.

Court met pursuant to adjournment.

Before:

Hon. Evan A. Evans, Circuit Judge.

Hon. Otto Kerner, Circuit Judge.

Hon. Sherman Minton, Circuit Judge.

Commissioner of Internal Revenue,	} Petition for Review	
<i>Petitioner,</i>		of Decision of the
8426 <i>vs.</i>		Tax Court of the
The John Kelley Company,		United States.
<i>Respondent.</i>		

This cause came on to be heard of the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on February 19, 1943, be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said Tax Court of the United States.

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UNITED STATES CIRCUIT COURT OF APPEALS,

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of proceedings had and papers filed, excepting briefs of counsel, motions and orders extending time for filing briefs and motions relative to argument of the case, in:

Cause No. 8426.

Commissioner of Internal Revenue,

*Petitioner,*

*vs.*

The John Kelley Company,

*Respondent,*

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 16th day of January, A. D. 1945.

(Seal)

(signed) Kenneth J. Carrick,  
*Clerk of the United States Circuit Court  
of Appeals for the Seventh Circuit.*

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 30, 1945.

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted; and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.